

UT 96-11  
Tax Type: USE TAX  
Issue: Graphic Arts Exemption  
Machinery & Equipment Exemption - Manufacturing

STATE OF ILLINOIS  
DEPARTMENT OF REVENUE  
OFFICE OF ADMINISTRATIVE HEARINGS  
CHICAGO, ILLINOIS

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THE DEPARMTENT OF REVENUE	)	
OF THE STATE OF ILLINOIS	)	No.
	)	IBT No.
v.	)	NTL No.
	)	
TAXPAYER	)	Charles E. McClellan
	)	Administrative Law Judge
Taxpayer	)	

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**RECOMMENDATION FOR DISPOSITION**

**APPEARANCES:** Richard Rohner, Special Assistant Attorney General,  
for the Department of Revenue; John B. Truskowski of Keck, Mahin &  
Cate for TAXPAYER

**Synopsis:**

This matter came on for hearing pursuant to the taxpayer's timely protest of a Notice of Tax Liability (NTL) issued to TAXPAYER by the Department of Revenue dated March 27, 1995 for Retailers' Occupation Tax ("ROT") and Use Tax. The Notice of Tax Liability, number XXXXX, covers the audit period of July 1, 1988 through November 30, 1993. The issue is whether the solvent purchased by the taxpayer for mixing with base ink it purchases for printing on the plastic packaging material it manufactures is exempt from tax as a

component of a product manufactured for resale. Following the submission of all evidence and a review of the record, it is recommended that the assessment be reduced and, as so adjusted, this matter be resolved in favor of the Department.

**Findings of Fact:**

1. The Department's *prima facie* case against TAXPAYER, including all jurisdictional elements, was established by the admission into evidence of the Correction of Returns, showing tax due of \$32,571, penalty of \$8,465 for a total liability due and owing, before statutory interest and payments made by the taxpayer are taken into account, in the amount of \$41,036. (Tr. pp. 8, 9; Dept. Grp. Exs. No. 1).

2. Taxpayer is in the business of manufacturing flexible packaging materials, including the printing thereon, for various industries. (Tr. p. 11, 12).

3. The products produced by taxpayer include plastic packaging for bread, bags for McDonalds, Jewel ice bags and Kleenex packaging. (Tr. p. 12).

4. The taxpayer purchases two types of ink for printing on the packaging materials it produces. (Tr. p. 12).

5. Some of the inks are usable by the taxpayer just as they come out of the containers in which they are received. (Tr. p. 12).

6. Other inks purchased by the taxpayer are base color inks that the taxpayer mixes to achieve certain colors and viscosities. (Tr. p. 12).

7. Solvents are also mixed with the base inks to achieve the desired color and viscosity. (Tr. p. 12).

8. The solvent normally used is propyl alcohol. (Tr. p. 19).

9. The design of the packaging material and the weather are two of the factors which determine how much solvent to add. (Tr. p. 13).

10. In the process of using the ink there is an evaporation rate of the solvent. (Tr. p. 18).

10. The amount of solvent that becomes part of the ink product as compared to evaporation is 5.4%. (Tr. p. 22).

#### **Conclusions of Law:**

With one exception, the record in this case, shows that this taxpayer has failed to demonstrate by the presentation of testimony or through exhibits or argument, evidence sufficient to overcome the Department's *prima facie* case of tax liability under the assessments in question. The exception results from the stipulation of the parties that 5.4% of the solvent used by the taxpayer is incorporated into the product for resale and requires that the tax assessment of \$32,571 be reduced by \$1,533 (5.4%) to \$31,038. Accordingly, by such failure, and under the reasoning given below, the determination by the Department that TAXPAYER owes the assessments shown on the Corrections of Return, as revised to take into account the stipulation regarding the amount of solvent that is incorporated into the product, must stand as a matter of law. This conclusion is based on the following analysis.

#### **Analysis:**

Section 2 of the Use Tax Act (35 ILCS 105/2) defines the term "Use" in broad terms and then sets forth two artificial exclusions,

only the first of which is relevant to this case. The relevant exclusion is for tangible personal property purchased as an ingredient to be incorporated in other tangible personal property to be sold in the regular course of business. The purpose of this exclusion is to avoid double taxation. Granite City Steel Co. v. Department of Revenue, 30 Ill.2d 552 (1964). The Retailers' Occupation Tax contains an identical exclusion at 35 ILCS 120/1. To come within the exclusionary language, the property in question must be incorporated into the manufactured product for resale. Hemmer v. Department of Revenue, 41 Ill.2d 267 (1968).

In the instant case, the testimony was to the effect that the solvent in question evaporates to a large extent. Consequently, it does not become part of the product to that extent. Rather, it is used by the taxpayer in the manufacturing process. The taxpayer, being the final user of the evaporated solvent, is liable for use tax on that portion of the solvent.

The parties stipulated that 5.4% of the total solvent purchased by the taxpayer becomes part of the end product for resale. Therefore, that portion of the solvent, representing \$1,533 of the use tax assessment, qualifies for the exclusion.

The Circuit Court of Cook County recently decided a case (93 L 51214) with facts virtually identical to those in this case. In that case the court held that solvents used by the taxpayer in formulating ink and lacquer were not excludable from taxation because they evaporated and, therefore, were not incorporated into a manufactured product for resale.

WHEREFORE, for the reasons stated above, it is my recommendation that the Department's assessment of tax as calculated on the Corrections of Returns, be reduced by \$1,533 for the 5.4% of the solvent that becomes incorporated in the manufactured product, and that the assessment as so adjusted be sustained, with interest and penalties recalculated accordingly.

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Date

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Charles E. McClellan  
Administrative Law Judge